

## **Benoît Cœuré: Drawing lessons from the crisis for the future of the euro area**

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at “Ambassadors Week”, Paris, 27 August 2015.

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Your Excellencies,

Thank you for your invitation. Here in the ministry where Robert Schuman made his historic declaration on 9 May 1950, everyone understands that the European project is inextricably an economic and political project.

The same is true of the euro. The single currency reflects a political desire to unite Europe and aims to reap the benefits of a larger and better integrated economic area to support growth and job creation.

The current crisis represents a fundamental test of our monetary union’s ability to achieve that dual objective, and it seems to me that there are two lessons that we should learn from it.

The first is that the people of Europe and their governments are far more attached to the single currency than certain observers have suggested.

The second is that our institutional framework is not yet sufficient to complete Economic and Monetary Union when it comes to economic, fiscal and financial matters. The ECB does not currently have a strong political counterpart in these areas. Thus, our monetary union will remain imperfect, will not be as prosperous as it could be and will face the risk of repeated crises if we fail to address our economic and political differences.

As the authors of a recent article entitled “Monnet’s Error?” concluded, the European project is on hold: “There is no desire to go backward [and] no interest in going forward, but it is economically unsustainable to stay still.”<sup>1</sup>

I would like to say a few words today about the major challenge that this poses and what we can do about it.

### **1. The paradox of the euro during the crisis**

It should be noted, first of all, that the euro has proved to be something of a paradox: confidence in the single currency remains very high, despite the fact that the euro area is struggling to emerge from the crisis and the fragilities of our economic and political union have threatened the integrity of the euro area on several occasions.

#### **a) Confidence in the single currency**

During the crisis, certain observers have underestimated the extent to which the people of Europe and their governments support the euro.

In spring 2015 a very large majority of the *population* of the euro area was in favour of the single currency.<sup>2</sup> 69% of respondents to the Eurobarometer survey were in favour of Economic and Monetary Union and the euro, 25% were against it and 6% were undecided.

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<sup>1</sup> Guiso, L., Sapienza, P. and Zingales, L., “Monnet’s Error?”, paper presented at the Brookings Panel on Economic Activity, autumn 2014.

<sup>2</sup> See Standard Eurobarometer 83, Question QA18.1.

That figure of 69% is close to the highest value recorded since 2004 for that question (which stands at 70%).

The *countries* of the euro area have also reaffirmed, on several occasions, their commitment to the euro and their determination to preserve our monetary union. On 13 July they made it clear that they wanted Greece to remain in the euro area. Indeed, not only has the euro area not shrunk, as some people have forecasted, it has actually grown in size. The figures speak for themselves: the number of member countries has increased by almost 50% since the start of the financial crisis, rising from 13 to 19.<sup>3</sup>

The *rest of the world* has also maintained its confidence in the euro. The single currency continues to play a key role at international level, remaining one of the world's two major currencies,<sup>4</sup> and its share of global foreign exchange reserves has remained broadly unchanged since the crisis began in 2007.<sup>5</sup> This year, against the background of the historically low interest rates in the euro area, the euro has been increasingly used as a funding currency by international borrowers.<sup>6</sup> And in April 2015 Mexico became the first sovereign state to issue a bond denominated in euro with a maturity of 100 years.

There are several different factors that could explain that confidence in the single currency. First of all, the euro forms an integral part of the European identity.<sup>7</sup> It is also considered to guarantee stability (by protecting purchasing power) and provide protection against the risk of exchange rate crises. This aspect is directly linked to the credibility of the ECB's monetary policy, which has demonstrated its ability to act to maintain price stability. Finally, sharing a currency establishes common interests, from both a financial and a geopolitical perspective.

We can build on that confidence in the euro in order to strengthen our monetary union. The ECB's fundamental objective is to protect the euro, hence it is imperative that we fulfil our mandate by keeping inflation below, but close to, 2%, which explains all of our monetary policy decisions during the crisis.

#### **b) *The fragilities of our economic union***

At the moment, however, there is no such confidence in our ability to fully reap the economic benefits of our monetary union and ensure stability and growth in the euro area. In the spring of 2015, 45% of respondents in the euro area said they believed that the worst of the crisis was yet to come.<sup>8</sup>

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<sup>3</sup> Malta and Cyprus joined the euro area in 2008, followed by Slovakia in 2009, Estonia in 2011, Latvia in 2014 and Lithuania in 2015.

<sup>4</sup> European Central Bank, *The international role of the euro*, July 2015.

<sup>5</sup> At constant exchange rates, the euro's share of global foreign exchange reserves has fallen by 1 percentage point (to 22%) since the end of 2007, while that of the US dollar has declined by 5 percentage points (to 63%). Thus, the decline in the share of the euro at current exchange rates is essentially a reflection of the euro's depreciation over that period. In 1998 the combined share of the national currencies that preceded the euro stood at 15%.

<sup>6</sup> Accounting for almost 30% of new issuance.

<sup>7</sup> A Eurobarometer survey conducted at the end of 2014 for the European Parliament found that the euro was the most important element of the European identity (being mentioned by 50% of respondents in the euro area), ahead of the values of democracy and freedom (49%), culture and history. See European Parliament Eurobarometer 82.4, Question QP11, January 2015.

<sup>8</sup> According to the spring 2015 Eurobarometer survey referred to above. In the European Parliament Eurobarometer survey, 51% of respondents said that having the euro had not mitigated the negative impact of the crisis. Finally, in a survey conducted by Opinium Research between 29 June and 10 July 2015, 63% of respondents in the euro area (a sample of more than 6,000 people living in France, Germany, the Netherlands, Italy, Spain and Portugal) said they thought that the Greek debt crisis had been handled badly at European level.

The crisis showed that excessive imbalances and fragilities had been allowed to develop in a number of euro area countries in the absence of sufficient safeguards: investment in the housing sector instead of the productive economy, excessive risk taking in the banking sector and massive external indebtedness. Participating countries have taken the benefits of the euro for granted without acknowledging their shared responsibility.<sup>9</sup> The negative effects of this process became brutally apparent during the euro area sovereign debt crisis, and even now, five years after that crisis began, they are still weighing on economic activity and employment.

The consequences are not just economic; they are also political. In the worst affected countries, convergence in GDP per capita has been reversed, casting doubt on one of the fundamental objectives of the single currency.<sup>10</sup> Unemployment hits the young hardest, creating a lost generation. What is more, recent studies have shown that increases in debt and unemployment in one euro area country affect confidence in the EU in other Member States as well.<sup>11</sup> This is an additional element of the interdependence that the single currency has created among the countries that use it.

### **c) *An imperfect political response***

Thus, we have a shared interest in resolving the imbalances and economic fragilities in the euro area. However, the political response during the crisis has been complicated by several factors.

It has been necessary to develop new instruments as a matter of urgency in the midst of the crisis. Some of those instruments, particularly the financial assistance programmes, are governed by a decision-making mechanism which is not conducive to the development of shared responsibility for policies concerning the future of the euro area. This intergovernmental decision-making process involves endless negotiations, particularly when it comes to issues with redistributive implications, and highlights the differences between the positions of the various Member States. Thus, it runs the risk of a conflict between the legitimate democratic interests of individual countries, without offering sufficient legitimacy at European level in return.

The *raison d'être* of this approach is, admittedly, to allow each government to sign up to shared decisions. However, experience shows that it does not ensure that governments take ownership of those decisions at national level. What is more, it does not prevent the polarisation of the debate at European level or the temptation to engage in nationalist posturing. Finally, it does not facilitate the establishment of a growth strategy based on the aggregate position of the euro area, the systemic risks associated with national fragilities and interaction between these various levels.<sup>12</sup>

To sum up, maintaining this approach would condemn us to a future of low growth and repeated crises. At a time when global growth may be slowing down, it is our shared responsibility to avoid the same fate befalling the euro area.

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<sup>9</sup> The overconsumption of the benefits of monetary union, like that of natural resources, is an example of the "tragedy of the commons". See Hardin, G., "The Tragedy of the Commons", *Science*, Vol. 162, No 3,859, 13 December 1968.

<sup>10</sup> "Real convergence in the euro area: evidence, theory and policy implications", *Economic Bulletin*, Issue 5, ECB, May 2015.

<sup>11</sup> Ioannou, D., Jamet, J.-F. and Kleibl, J., "Spillovers and Euroscepticism", *Working Paper Series*, No 1815, ECB, June 2015.

<sup>12</sup> These various points are addressed in a recent interview with *Le Monde*, which was published on 27 July 2015.

## 2. Renewing the European project

We must be clear, however: the euro area is an irreversible project, not simply a fixed exchange rate system. This statement is all the more necessary as the recent negotiations concerning Greece have let the evil genie of a country exiting the euro area (even temporarily) out of the bottle. The exit of a member country would inevitably lead economic actors to wonder who would be next, with all the potential destabilising effects that such speculation could entail. The genie will not be put back in its bottle once and for all until it is clear that such a risk will not rear its head again.

We need to use the confidence in the single currency to build institutions that will reinforce the cohesion of our economic and political union.

To achieve this, we need to recreate the sense of shared responsibility. This will require the objectives of political and economic integration in the medium term to be better defined, and work will need to begin immediately to implement them. And as this will not be possible without the support of European citizens, we must respond to their concerns in the short term, by reducing unemployment and consolidating the recovery.

### a) Our shared goals

Since 2010, the integration of the euro area has progressed under the pressure of the crisis, with agreements often reached at the last minute. We all have in mind Jean Monnet's remark that "Europe will be forged in crises, and will be the sum of the solutions adopted for those crises".<sup>13</sup> But some of these solutions, improvised in a hurry, are not always long lasting. For example, the European Stability Mechanism is an impressive achievement and could become the foundation of a "euro area Treasury", under the condition that it is brought under the umbrella of the EU's treaties and under the control of the European Parliament.<sup>14</sup>

"Integration by crisis" has proved effective, but it no longer inspires the support of the citizens (if it ever did). So, the euro must be associated with a positive "narrative" and equipped with the necessary instruments, making sure that they are subject to democratic oversight.

What are Europe's collective goals? What are the public goods that require joint action? Obviously, the scope of such reflection goes beyond just the economic sphere; it also encompasses key determinants of power, such as technology, energy and even foreign policy and security. In federations, public investment in such common goods is centralised.<sup>15</sup> Here in the European Union, we are a long way from that. And yet, we face the same international challenges.

We are asking ourselves these questions so we can identify what we must do better together, but also to avoid the duplication of competences by identifying areas where political action is more effective and legitimate at local or national level.<sup>16</sup>

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<sup>13</sup> Monnet, J., *Mémoires*, Fayard, 1976.

<sup>14</sup> The "Five Presidents' Report" ("Completing Europe's Economic and Monetary Union", a report prepared by J.-C. Juncker, in close cooperation with D. Tusk, J. Dijsselbloem, M. Draghi and M. Schulz, 22 June 2015) recommends integrating the intergovernmental solutions (the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the Euro Plus Pact, the Intergovernmental Agreement on the Single Resolution Fund and the European Stability Mechanism) into the legal framework of the EU.

<sup>15</sup> Cottarelli, C. and Guerguil, M. (eds.), *Designing a European Fiscal Union: Lessons from the Experience of Fiscal Federations*, Routledge, 2014.

<sup>16</sup> In particular, the economic literature uses as a criterion the comparison between, on the one hand, the heterogeneity of preferences and situations and, on the other, the externalities linked to different policies. It also highlights the need for a dynamic approach to take into account the economic and political factors of convergence and divergence. See, in particular, Alesina, A. and Wacziarg, R., "Is Europe Going Too Far?", *Journal of Monetary Economics*, Carnegie-Rochester Conference Volume, 1999, pp. 1–42; Cœuré, B. and Pisani-Ferry, J., "The governance of the European Union's international relations: how many voices?", in

In the economic sphere, what should our shared goals be? The “Five Presidents’ Report”<sup>17</sup> seeks to answer this question from the perspective of our monetary union. But the question is also relevant for the internal market, and thus for the European Union as a whole.

The Five Presidents’ Report stresses that we need to reinforce the stability of our economies by developing solidarity mechanisms, in particular within the monetary union, while ensuring that governments and economic actors behave responsibly. This is what has been done within the framework of the banking union, and it’s what we must aim to do within the framework of the capital markets union.<sup>18</sup>

Likewise, greater risk sharing in the fiscal sphere presupposes sufficient economic convergence among participating countries. Solidarity cannot turn into a system of permanent transfers, which is not part of the founding “contract” of monetary union. To put it another way, this is about establishing a new European social contract, which can be designed only under John Rawls’ “veil of ignorance”.<sup>19</sup>

Such greater risk sharing also presupposes responsible fiscal policies, which are in the interests of both individual countries and their neighbours. I want to make this clear: we cannot advocate a Europe of solidarity while believing that the economic policies of each euro area country are the business of that country’s parliament alone. The crisis has fully exposed that contradiction.

Second, efficiency gains could be achieved if we were to progressively pool certain resources within the framework of the single market – with such action being justified by economies of scale and scope, network effects and externalities. This was the logic behind the establishment of the European Coal and Steel Community in 1951, and today it informs the Juncker Plan, as well as efforts to develop an energy union and a single digital market.

The joint implementation of a political project and an economic strategy also assumes that our political union will be strengthened.

To remedy the “executive deficit”<sup>20</sup> – in other words, to reduce the difficulties involved in taking decisions that I mentioned earlier – we should favour sharing decisions that affect the future of the euro area within common institutions with a European mandate and democratic oversight at European level. How would the Governing Council of the ECB have dealt with the crisis if it was just a club of 19 national governors making decisions by consensus?

Following the lead of Jean-Claude Trichet,<sup>21</sup> I have spoken out in favour of the creation of a finance ministry for the euro area under the oversight of the European Parliament. This ministry could be responsible for preventing economic and fiscal imbalances, managing

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Sapir, A. (ed.), *Fragmented Power: Europe and the Global Economy*, Bruegel, 2007; and Jamet, J.-F., “The Optimal Assignment of Prerogatives to Different Levels of Government in the EU”, *Journal of Common Market Studies*, 49, 2011, pp. 563–584.

<sup>17</sup> “Completing Europe’s Economic and Monetary Union”, a report prepared by J.-C. Juncker, in close cooperation with D. Tusk, J. Dijsselbloem, M. Draghi and M. Schulz, 22 June 2015.

<sup>18</sup> *Building a Capital Markets Union*, Eurosystem contribution to the European Commission’s green paper, 21 May 2015.

<sup>19</sup> Rawls, J., *A Theory of Justice*, Harvard University Press, 1971. See also Cœuré, B., “Revisiting the European social contract”, speech given at the European Conference at Harvard – Europe 2.0 Taking the Next Step, Cambridge, Massachusetts, 2 March 2013.

<sup>20</sup> Chopin, T., “Vers un véritable pouvoir exécutif européen: de la gouvernance au gouvernement”, *Question d’Europe* No 274, Robert Schuman Foundation, 15 April 2013; and Véron, N., “The Political Redefinition of Europe”, opening remarks at the conference organised by the Swedish Financial Markets Committee (FMK) on “The European Parliament and the Financial Markets”, Stockholm, 8 June 2012.

<sup>21</sup> “Building Europe, building institutions”, speech by Jean-Claude Trichet, President of the ECB, on receiving the Charlemagne Prize 2011 in Aachen on 2 June 2011.

crises in the euro area and managing the budgetary capacity envisaged by the Five Presidents' Report, as well as representing euro area governments in international economic and financial institutions.

**b) What to do in the short term**

None of what I have mentioned will be possible without the support of European citizens. What do they expect? That unemployment will fall and growth will strengthen. There is a temptation to leave it up to the low oil price and the ECB's accommodative monetary policy. Monetary policy can support growth but it cannot create it in a lasting way. And the effectiveness and legitimacy of euro area governance will not be increased by placing excessive demands on the central bank – quite the opposite.

I think it is vital in the short term that the banking union be finalised, with, in particular, an early agreement on a common backstop for the Single Resolution Fund and the progressive implementation of a European deposit insurance scheme, accompanied by reforms uncoupling once and for all the solvency of banks from that of governments. Second, if the euro area is *one* economy and not the sum of 19, we must have a common growth strategy based on the identification of our structural weaknesses and a collective discussion regarding the reforms to be implemented. The key words must be "*productivity*" and "*employment rate*", which are positive-sum games – not "*competitiveness*", which is a zero-sum game. Participating countries will not support euro area growth by competing for their neighbours' market shares.

**Conclusion**

There is nothing inevitable about the status quo, but, to go beyond it, we need to rediscover the spirit of Robert Schuman. In 1950, this French Foreign Minister had the political courage to propose to Germany that the two countries pool their economic resources<sup>22</sup> and share sovereignty within a common institution.<sup>23</sup> This gave birth to European integration.

Let's not forget that shared ambition is a powerful driving force. Herbert Blankenhorn, then Adenauer's diplomatic advisor, recorded in his diary the Chancellor's words of 24 May 1950 and the optimism inspired in him by Schuman's plan: "Wenn Furcht beseitigt werde, werde Europa wie ein genesender Kranker seine Kräfte wiederfinden"<sup>24</sup> ["Once fear has been overcome, Europe, like a convalescing patient, will find its strength again"].

Thank you for your attention.

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<sup>22</sup> Carbon and steel production.

<sup>23</sup> "The French government proposes that Franco-German production of coal and steel as a whole be placed under a common High Authority, within the framework of an organisation open to the participation of the other countries of Europe." Declaration by Robert Schuman, French Foreign Minister, 9 May 1950.

<sup>24</sup> Quoted by Rieben, H., Nathusius, M., Nicod, F. and Camperio-Tixier, C., *Un changement d'espérance: La Déclaration du 9 mai 1950*, Jean Monnet Foundation for Europe, European Research Centre, 2000, pp. 251–253.